



# **INTERNAL CONTROL GUIDELINES**

**DECEMBER 1982**

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GUIDELINES FOR  
THE EVALUATION AND IMPROVEMENT OF  
AND REPORTING ON INTERNAL CONTROL SYSTEMS  
IN THE FEDERAL GOVERNMENT

## FOREWORD

The Budget and Accounting Procedures Act of 1950 required that each agency head establish and maintain systems of accounting and internal control. The expectation was that such systems would help to prevent fraud, waste, abuse, and mismanagement in Federal Government operations.

The Act notwithstanding, instances of fraud, waste, and abuse continued to occur at an unacceptable level. Indeed, a GAO report, issued in August, 1980, found widespread, similar, and prevalent control weaknesses in the Federal Government.

The Reagan Administration, as part of Reform 88, is committed to streamlining the management and administration of the Federal Government. This includes reducing fraud, improving management controls, and eliminating errors in the administration of government programs. In October, 1981, the Office of Management and Budget issued Circular A-123 as an early effort to improve controls. Like the 1950 Act, the Circular required the head of each department and agency to develop and maintain adequate systems of internal control. Unlike the Act, however, it defined requirements and responsibilities in order to transform the 1950 Act expectations into reality.

The Congress has likewise expressed its support for good internal management in the Federal Government. In September, 1982, the Congress passed the Federal Managers' Financial Integrity Act (P.L. 97-255). This Act requires that each Executive agency's internal accounting and administrative controls be established in accordance with standards prescribed by the Comptroller General, and provide reasonable assurance that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded; and
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for.

The Act also requires OMB to establish, in consultation with the Comptroller General, guidelines with which the agencies can evaluate their systems of internal accounting and administrative control. In addition, it requires an annual statement from the head of each Executive agency to the President and the Congress stating whether or not the agency's system of internal accounting and administrative control complies with the requirements of the Act, and identifying the agency's material control weaknesses, if any, and its plans for correcting the weaknesses.

This document contains the guidelines required by the Act to be developed by OMB. It is to be used by each agency's management as guidance in the development of its own specific plans for performing a self-evaluation of, improving, and reporting on the agency's internal control system in the most efficient and effective manner consistent with the agency's unique missions and organizational structures.

The Act also requires the head of each Executive Agency to report on whether the agency's accounting system conforms to principles, standards, and related requirements prescribed by the Comptroller General. Guidelines for meeting this requirement are being issued under separate cover.

A handwritten signature in black ink, reading "David A. Stockman". The signature is written in a cursive, flowing style with a long horizontal line extending from the end.

DAVID A. STOCKMAN  
DIRECTOR

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## CHAPTER I

### INTRODUCTION

Internal Control, for the purpose of these guidelines, is defined as the steps a Federal agency takes to provide reasonable assurance that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

An internal control system is the organizational structure and the sum of the methods and measures used to achieve the objectives of internal control.

An internal control system should not be a separate system in an agency. It should be an integral part of the systems used to operate the programs and functions performed by the agency. Thus, internal control would be the responsibility of the same individuals who are responsible for operating the programs and functions. This enables the objectives of internal control to be accomplished in the most efficient and effective manner.

## HISTORY AND SCOPE OF INTERNAL CONTROLS WITHIN THE FEDERAL GOVERNMENT

The Budget and Accounting Procedures Act of 1950 required that each agency establish and maintain systems of accounting and internal control. It is widely recognized that these systems are necessary not only for financial and administrative activities, but for program and operational activities involving funds, property, and other assets for which the agency is responsible. Indeed, the 1950 Act, by definition, encompassed not only systems of internal control that provide full disclosure of an agency's financial results, adequate financial information for agency management purposes, reliable accounting results, and suitable integration of agency accounting and Treasury Department accounting. It also encompassed systems of internal control that provide "effective control over the accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit."

At the same time, it was, and still is, clear that internal control is concerned with only the operational aspects of a program or function. It does not encompass such matters as statutory development or interpretation, determination of program need, resource allocation, rulemaking, or other discretionary policymaking processes in an agency.

An increasing awareness, however, of a need to strengthen internal control systems in the Federal Government led to the issuance of OMB Circular A-123, "Internal Control Systems," in October, 1981. Included in the requirements of Circular A-123 were:



- The assignment of internal control responsibilities to specific officials throughout each agency.
- The completion of vulnerability assessments covering all agency components by December 31, 1982, and not less frequently than biennially thereafter.
- The performance of internal control reviews on an ongoing basis.
- The establishment of administrative procedures to enforce the intended functioning of internal controls, including provisions that performance appraisals reflect execution of internal control responsibilities and procedures to take necessary actions to correct internal control weaknesses on a timely basis.

Finally, in 1982 the Congress enacted the Federal Managers' Financial Integrity Act, requiring each Executive agency not only to have internal accounting and administrative controls for these systems, but also to perform ongoing evaluations and provide an annual statement on the control systems to the President and the Congress. More specifically, the Act requires:

- The establishment of internal accounting and administrative controls (typically characterized as simply "internal controls") in each Executive agency in accordance with standards prescribed by the U.S. Comptroller General.
- The conduct of evaluations by agencies of their systems of internal accounting and administrative control in accordance with guidelines issued by the Director of the Office of Management and Budget.

- Transmittal of an annual statement by the head of each Executive agency to the President and Congress indicating whether the agency's systems of internal accounting and administrative control comply with the Comptroller General's standards and provide reasonable assurance that obligations and costs are in accordance with applicable law; funds, property, and other assets are safeguarded; and revenues and expenditures are properly recorded and permit the preparation of reliable financial and statistical reports.

The purpose of this publication is to provide guidance for the evaluation and improvement of and reporting on internal control systems in Executive agencies in conformance with the Act. Each Executive agency is expected to use this guidance to assist in the development of its own specific plans in order that management can perform a self-evaluation of, improve, and report on its internal control system in the most efficient and effective manner consistent with its own unique missions and organizational structure.

#### THE BASIC APPROACH TO EVALUATING, IMPROVING AND REPORTING ON INTERNAL CONTROLS

An evaluation of and reporting on internal control can be approached in several ways. The approach presented in this publication provides an efficient and effective way, based on techniques used to evaluate and report on the internal controls associated with financial statements, but expanded to encompass the controls necessary for administrative and program activities with systems subject to these guidelines.

The recommended approach for evaluating, improving, and reporting on internal controls is comprised of seven phases:

- Organizing the process. This includes a determination as to the information and assurances to be provided to the agency head to enable the annual statement to be made to the President and the Congress; the assignment of responsibilities for planning, directing, and controlling the evaluation process throughout the agency; and the development of an information system that provides a tracking of the status of the evaluations and corrective actions as well as other pertinent information necessary to manage the overall process and facilitate preparation of the annual report.
- Segmenting the agency into organizational components, and then identifying the programs and administrative functions conducted in each component. For example, the Department of Health and Human Services can be segmented into the Social Security Administration, the Health Care Financing Administration, etc. The Social Security Administration, in turn, could be segmented into the Supplemental Security Income program, the Old-Age Survivors Insurance program, etc.; or into administrative functions such as eligibility determination systems, benefit payment systems, quality control, etc.
- Assessing the vulnerability to waste, loss, unauthorized use, or misappropriation of the funds, property or other assets within each component and deciding which are the most vulnerable. This is done by identifying the factors that create an inherent riskiness in the function, considering the operating environment in which the function is performed, and preliminarily evaluating whether safeguards exist to prevent waste, loss, unauthorized use, or misappropriation from occurring.

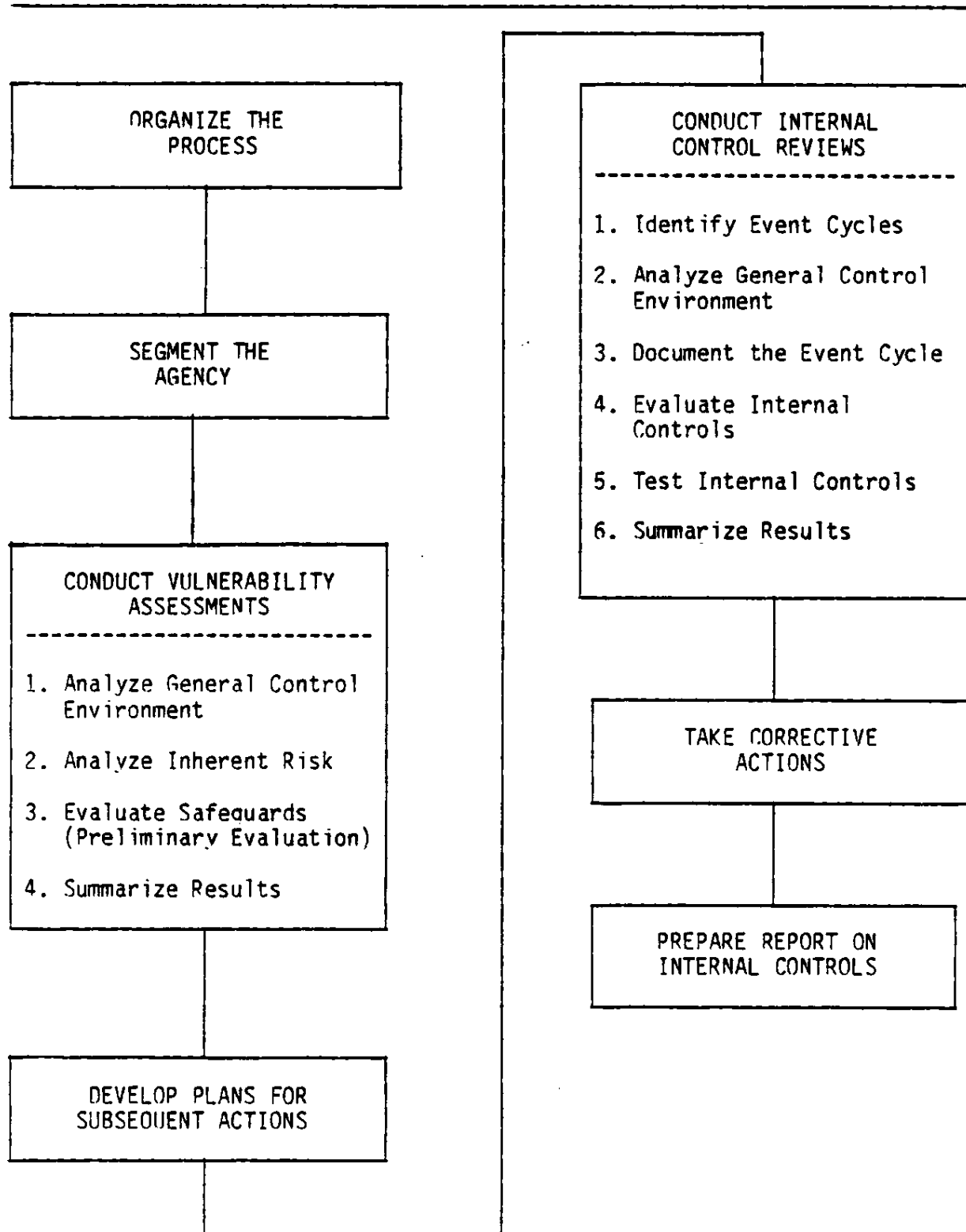
- Developing plans and schedules for the performance of internal control reviews and other actions, based on an evaluation of the results of the vulnerability assessments and other considerations (management priorities, resource constraints, etc.), and in such a manner as to provide that internal controls in those programs and administration functions deemed to be the most vulnerable, as well as those deemed to be less vulnerable, are evaluated and improved as necessary to ensure a strong system of internal control.
- Reviewing the internal controls for the selected programs and administrative functions, determining whether adequate control objectives have been established and control techniques exist and are functioning as intended, and then developing recommendations to correct weaknesses in either the design or functioning of the internal control system.
- Determining, scheduling, and taking the necessary corrective actions for improving internal controls on a timely basis. Included in the determination should be an analysis to assure that the expected benefits to be obtained will outweigh the costs of any improvements made.
- Preparing the annual statement to the President and the Congress on the status of the agency's system of internal control, as required by the Act.

This recommended approach is depicted in a flow chart (Exhibit 1) and explained in detail in Chapters II to VI.

The above process is not an attempt to evaluate discretionary policy decisions. Rather, the evaluation process begins at the point at which a program or function has been authorized by the policy-level official having authority to do so, and focuses on the steps involved in the operation of the program. For example, the review of a welfare assistance program should not include an evaluation of whether the eligibility criteria are consistent with the statute and its legislative history. Instead, the review should evaluate whether the operation of the program is consistent with the criteria and thus there is reasonable assurance that obligations and costs are in compliance with the applicable law; funds, property and other assets are safeguarded; and revenues and expenditures are properly recorded.

EXHIBIT 1

OVERVIEW OF THE INTERNAL CONTROL EVALUATION,  
IMPROVEMENT, AND REPORTING PROCESS



## INTERNAL CONTROL STANDARDS

As stated in the Act, each Executive agency is to establish a system of internal accounting and administrative controls in accordance with standards prescribed by the Comptroller General. The following is consistent with our understanding of those standards, as they are to appear in the General Accounting Office document: Standards for Internal Control in the Federal Government.

- Reasonable Assurance -- Internal control systems shall provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This standard recognizes that the cost of internal control should not exceed the benefits derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives.
- Attitude -- Managers and employees are to maintain and demonstrate a positive and supportive attitude toward internal control at all times.
- Competent Personnel -- Managers and employees are to have high standards of integrity, are to be competent by education, experience, and/or training to accomplish their assigned duties, and are to possess adequate knowledge of internal control.
- Internal Control Objectives -- Specific internal control objectives are to be developed for each agency activity. The control objectives must be complete, logical, and applicable to the specific activity and are to be consistent with the accomplishment of the overall objectives of internal control specified in the Act\*.

\*The overall internal control objectives specified in the Act are:

- (1) Obligations and costs are in compliance with applicable law.
- (2) Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
- (3) Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

- Internal Control Techniques -- Internal control techniques, i.e., processes and documents that accomplish the internal control objectives, are to be designed for and operated in all agency activities, in order to comprehensively accomplish the control objectives on a consistent basis, and in an efficient and effective manner.
- Documentation -- Internal control systems, i.e., control objectives and internal control techniques, the accountability for resources, and all transactions and other events shall be clearly documented. Documentation shall be readily available.
- Recording of Transactions -- Transactions shall be recorded as executed, when executed, and be properly classified.
- Execution of Transactions -- Independent evidence shall be maintained that authorizations are issued by persons acting within the scope of their authority and that transactions conform with the terms of the authorizations.
- Separation of Duties -- Key duties such as authorizing, approving, and recording transactions, issuing or receiving assets, making payments, and reviewing or auditing shall be assigned to separate individuals to minimize the risk of loss to the government. Internal control depends largely on the elimination of opportunities to conceal errors or irregularities. This in turn depends on the assignment of work in such a fashion that no one individual controls all phases of an activity or transaction, thereby creating a situation that permits errors or irregularities to go undetected.



- Supervision -- Qualified and continuous supervision shall be provided to assure that approved procedures are followed. Lines of personal responsibility and accountability shall be clear.
- Access to Resources -- Access to resources shall be limited to authorized personnel. Access includes both direct physical access and indirect access through the preparation or processing of documents that authorize the use or disposition of resources. Periodic comparison shall be made of the resources with the recorded accountability to determine whether the two agree. The frequency of the comparison shall be a function of the vulnerability of the asset.

The Federal Managers Financial Integrity Act also requires a standard concerning audit resolution and follow-up. The Comptroller General is defining that standard as follows:

- Managers should promptly evaluate findings and recommendations reported by auditors; determine proper action in response to audit findings and recommendations; and complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management's attention.

## CHAPTER II

### ORGANIZING THE EVALUATION

It is critical that an Executive agency, whether large or small, carefully organize and assign responsibilities in a manner that ensures that the evaluation, improvement, and reporting on internal controls is conducted in an efficient and effective manner. This includes providing for quality control over the entire process. The key organizing considerations include:

- Assigning responsibilities.
- Internal reporting.
- Documentation.
- Personnel and supervision.
- Scheduling the evaluation processes.

### ASSIGNING RESPONSIBILITIES

As noted earlier, an internal control system is not a separate system within an agency, but rather an integral part of the systems used by an agency to operate its programs and other activities. The Act recognizes this relationship and thus requires the head of the agency to be responsible for submitting a statement to the President and the Congress on the status of the agency's internal controls.

Because it is unrealistic to expect an agency head to have first-hand knowledge of the status of the agency's internal control system, the appropriate responsibilities should be carefully assigned to selected senior officials throughout the agency in order to ensure that the process of evaluating, improving, and reporting on internal controls is carried out in conformance with these guidelines, and in an efficient and effective manner. These senior agency officials should be expected to provide the agency head with written assurances that the responsibilities have been carried out.

The assignment of responsibilities should include the following:

- Direction of the agencywide effort --

One senior official should be responsible for coordinating the overall agencywide effort of evaluating, improving, and reporting on internal control in conformance with these guidelines. This official should be asked to provide assurance that these processes have been conducted, in accordance with the guidelines, in a thorough and conscientious manner. (See Appendix C)

- Heads of organizational units --

Just as the agency head is ultimately responsible for internal control in the agency, the head of each organizational unit in an agency is responsible for internal control in that unit. Accordingly, the head of each organizational unit (and other components identified in the segmenting process described in Chapter III) should provide assurance that he or she is cognizant of the importance of internal control; has performed the evaluative processes in his or her areas of responsibility in accordance with the OMB guidelines and in a conscientious manner; and believes that the objectives of internal control are complied with in his or her area of responsibility within the described limits. (See Appendix D)

- Inspector General or equivalent -- The Inspector General, or equivalent in agencies without an Inspector General, normally reviews internal control documentation and systems and reports the results of these reviews to appropriate levels of management. These reviews, which the IG undertakes either on his own initiative or at the request of the agency head, are either separate reviews of internal controls or performed in conjunction with internal audits.

In addition, however, the IG may be asked to provide comments as to whether the evaluation process has been conducted in accordance with these guidelines. IG comments in response to such a request may be based on a limited review to determine whether the first six phases described in Chapter I are carried out in a reasonable and prudent manner. (See Appendix E)

Performance of this limited review by the Inspector General should not be interpreted to preclude the Inspector General from providing technical assistance in the agency effort to evaluate internal controls, or as otherwise limiting the authority of the Inspector General. In fact, the Inspector General or equivalent is encouraged to provide technical assistance to further the overall goal of strengthening internal control systems. However, it is imperative that management throughout the agency be heavily involved in the evaluative process, since it is management that has primary responsibility for the maintenance of a strong system of internal control.

However, care should be taken to avoid duplication of work. To the extent that the Inspector General has conducted or is planning to conduct internal control reviews of certain agency activities, a determination should be made as to how these reviews can help accomplish the evaluations required by these guidelines. In those instances where the Inspector General agrees to conduct certain internal control reviews, the senior official designated by the agency head to direct the agencywide effort may rely on the internal control reviews performed by the Inspector General. However, the senior official is still primarily responsible for the overall judgments regarding compliance with the guidelines.

### INTERNAL REPORTING

An internal reporting and follow-up system should be established to monitor the accomplishment of the various tasks that make up the evaluation and improvement process. This system should be used to ensure that:

- Vulnerability assessments are scheduled and completed on a timely basis.
- Scheduled internal control reviews are completed on a timely basis.
- Corrective actions are taken on a timely basis.

The system also should be able to:

- Summarize information regarding the results of the vulnerability assessments, internal control reviews, and necessary corrective actions in order to support the annual statement to the President and the Congress.
- Gather other data necessary to evaluate other actions to improve internal control, e.g., status of training, impact on performance appraisals, other personnel actions.

Consideration should be given to coordinating or integrating this information system with the agency's audit follow-up information system.

### DOCUMENTATION

Adequate written documentation should be maintained. In particular, documentation should be maintained for activities conducted in connection with vulnerability assessments, internal control reviews, and follow-up actions to provide a permanent record of the methods used, the personnel involved and their roles, the key factors considered, and the conclusions reached. This information will be useful for reviewing the validity of conclusions reached, evaluating the performance of individuals involved in the assessments and reviews, and performing subsequent assessments and reviews.

### PERSONNEL AND SUPERVISION

It is essential that a sufficient level of staff resources be committed to the internal control evaluation process. As such, it is likely that the vulnerability assessments and internal control reviews will be performed by persons from various parts of the agency. Examples are the individuals who operate the systems being reviewed and persons from the central staffs. These individuals need to have a good understanding of the process in order that they can make appropriate judgments.

Some specific measures that should be considered in order to provide this understanding, as well as assure the necessary quality, are as follows:

- Orientation and training -- Orientation and/or training sessions should be provided to explain the objectives of and procedures for conducting vulnerability assessments and internal control reviews.

- Assignment of personnel -- Use of the "team" approach should be considered in order that small groups of individuals can perform assessments and/or reviews jointly. This provides some assurance that the limitations of one individual can be offset by the strengths of another. It also stimulates individual team members' thinking.
- Supervision -- Adequate supervision of personnel involved in the assessment and review processes should be provided for.
- Performance appraisal -- Administrative procedures should be initiated to evaluate performance in assessment and review activities. Personnel should be advised that this will be a factor in their overall performance evaluation.
- Technical assistance -- Technical assistance should be developed and provided to employees assigned to the process. A procedures manual to guide the performance of vulnerability assessments and internal control reviews, and containing appropriate standard forms, may be useful. Agency "experts" who can answer questions and provide other assistance in this area should be designated and their names provided to the reviewers. Informal guidance should be circulated periodically and periodic meetings of key personnel involved in the process held as still another means of information sharing.
- Monitoring -- A monitoring system should be developed to assure that assessments and reviews are performed adequately. One way would be to use an individual or small group to test assessments and reviews as deemed necessary. Another way would be to coordinate with the Inspector General's limited reviews of the process.

### SCHEDULING THE EVALUATION PROCESS

Scheduling the vulnerability assessments and internal control reviews should be done carefully with consideration given to resource availability, the performance of risk analysis and similar evaluations in accordance with other statutory or regulatory requirements, the cyclical nature of certain operations, and other relevant factors. It is necessary, however, to ensure that sufficient evaluative work is scheduled and completed in time to provide a basis for the annual statement to the President and the Congress.

Furthermore, as required by Circular A-123, vulnerability assessments should be completed for all agency activities by December 31, 1982, and not less frequently than biennially thereafter. It is suggested, therefore, that a schedule be prepared for each biennial cycle, which specifies the individual(s) responsible for performing each assessment and the date by which each is to be completed. Vulnerability assessments should be conducted as soon as possible for activities that are new or undergoing major changes rather than waiting for the next biennial cycle.

Internal control reviews are to be conducted on a continuous basis throughout the year. The schedule of internal control reviews should be developed based on an evaluation of the results of the vulnerability assessments and other considerations (management priorities, resource constraints, etc.) in order to ensure that agency activities determined to be highly vulnerable, as well as those which are less vulnerable, are evaluated and improved as necessary to provide a strong system of internal control. Preparation of a schedule similar to that discussed for the vulnerability assessments is recommended.

Since no exemption has been provided for classified or secure activities, they must be included in the evaluation process. Care should be taken, however, to assure that persons participating in the evaluations for such activities have the necessary security clearances and that the documentation is appropriately classified and handled.



## CHAPTER III

### IDENTIFYING PROGRAMS AND ADMINISTRATIVE FUNCTIONS

Federal agencies are large, complex organizations. The most effective way to systematically perform an evaluation of the systems upon which an agency head can submit a statement is to segment the agency first into organizational or other components and then into the programs and administrative functions within each component. This approach also facilitates the allocation of resources to the assessment process and the determination of who should be responsible for providing assurances.

### SELECTING THE COMPONENTS, PROGRAMS AND FUNCTIONS

There is no single method to divide an agency into components, programs, and administrative functions for purposes of evaluating the system of internal control, particularly since agencies vary so widely in organizational structure and the nature of activities conducted. The basic goal of the division is to develop an agency-wide inventory of "assessable units," each of which can be the subject of a vulnerability assessment. This inventory should provide complete coverage of all program and administrative functions, consistent with the discussion in Chapter I. The individual assessable units should be of an appropriate nature and size to facilitate the conduct of a meaningful vulnerability assessment.

In developing the inventory of assessable units, reference should be made to such sources of information as the agency's budget and related materials, organization charts, agency manuals, and program and financial management information systems. The following specific factors should be considered:

- Existing organizational structure.
- Nature and size of the agency's programs and administrative functions.
- Numbers of sub-programs or sub-functions in a program or function
- Number of separate organizations operating the program
- Degree of independence of the program or function
- Differences in operating systems
- Degree of centralization or decentralization
- Budget levels
- Numbers of personnel

The degrees of independence and centralization/decentralization are very significant. A program or administrative function could operate in several locations. Since the program or administrative function and internal control system may vary among locations--in design and/or operation--it may be necessary to perform separate vulnerability assessments and/or internal control reviews for each location. Thus a consideration when classifying programs and functions operating at several locations is whether to identify the locations first and then list the programs and functions operating within each location, or to identify the programs and functions first, and then for each multi-location program and function, identify and list the locations at which it operates. Either approach is acceptable, as long as coverage is complete.

Also, it should be remembered that the purpose of the review is to evaluate and improve the internal controls for operating programs and administrative functions. Policymaking activities and other activities not subject to the guidelines should not be included in the inventory. Appendix A shows a sample of a partial inventory of components, programs and administrative functions for a Cabinet-level department.

Once the agency inventory of assessable units has been developed, the information should be documented. (One possible format for such documentation is provided in Exhibit 2.) These lists provide the means for organizing and managing the evaluation process.

Agency Component: \_\_\_\_\_

List of Programs and Administrative Functions

Within the Component

Programs/Administrative Functions	Comments

Prepared by \_\_\_\_\_

Date \_\_\_\_\_

Reviewed by \_\_\_\_\_

Date \_\_\_\_\_

EXHIBIT 2

III-4

## CHAPTER IV

### VULNERABILITY ASSESSMENTS

A vulnerability assessment is a review of the susceptibility of a program or function, subject to the guidelines, to the occurrence of waste, loss, unauthorized use, or misappropriation. More specifically, a vulnerability assessment is intended to determine the likelihood that situations exist in which:

- (1) obligations and costs are not in compliance with applicable law;
- (2) funds, property, and other assets are not adequately safeguarded against waste, loss, unauthorized use, or misappropriation; and
- (3) revenues and expenditures applicable to agency operations are not properly recorded and accounted for and therefore do not permit the preparation of accounts and reliable financial and statistical reports or the maintenance of accountability over assets.

As indicated, however, the internal control evaluation process does not stop with vulnerability assessments since, by themselves, vulnerability assessments do not necessarily identify weaknesses or result in improvements. Rather, vulnerability assessments are the mechanism with which an agency can determine the relative potential for loss in these programs and functions, and then, after giving consideration to such relevant factors as management priorities, resource constraints, etc., schedule internal control reviews and related actions.

A vulnerability assessment consists of the following three steps:

1. Analysis of the general control environment.
2. Analysis of inherent risk.
3. Preliminary evaluation of safeguards.

#### ANALYSIS OF GENERAL CONTROL ENVIRONMENT

The environment in which activities are conducted has a major impact on the effectiveness of internal control within an agency. Several factors determine the general control environment, including the following drawn from the General Accounting Office document, Executive Reporting on Internal Controls in Government and the American Institute of Certified Public Accountants document, Report on the Special Advisory Committee on Internal Accounting Control:

- Management Attitude -- Management recognition of the importance of and commitment to the establishment and maintenance of a strong system of internal control as communicated to employees through actions and words.
- Organizational Structure -- The identification of organizational units to perform the necessary functions and the establishment of appropriate reporting relationships.
- Personnel -- the competence and integrity of the organization's personnel.
- Delegation and Communication of Authority and Responsibility -- Appropriate delegation or limitation of authority in a manner that provides assurance that responsibilities are effectively discharged.

- Policies and Procedures -- The definition, documentation and dissemination of information to all employees as to how the organization is intended to perform in various situations.
- Budgeting and Reporting Practices -- The specification and communication of organizational goals and the extent of their accomplishment.
- Organizational Checks and Balances -- The establishment of an appropriate level of financial and other management controls and internal auditing.
- ADP Consideration -- When utilized, an awareness of the strengths and exposures inherent in a system that uses ADP and the existence of appropriate controls.

An evaluation of the general control environment is the first step in the vulnerability assessment process. It should be performed by determining whether the characteristics of a strong general control environment, as described above, exist by (a) reviewing documented policies and procedures; (b) talking with management and other personnel; (c) observing practices; and (d) drawing upon a familiarity with the operation.

This evaluation may be performed for the component as a whole, or individually for each program and administrative function subject to the guidelines that is carried out within the component. The determining factors would be the size, nature, and degree of centralization of the programs and functions conducted within the agency component.

Exhibit 3 presents a form which may be useful in making the analysis.

Agency Component: \_\_\_\_\_

Analysis of General Control Environment

Program/Administrative Function -- \_\_\_\_\_

Factor	Evaluation		Comments
	Satisfactory	Other	
Management Attitude			
Organizational Structure			
Personnel			
Delegation and Communication of Authority and Responsibility			
Policies and Procedures			
Budgeting and Reporting			
Organizational Checks and Balances			
ADP Considerations			
Other Factors			

Overall Evaluation:

Prepared by \_\_\_\_\_ Date \_\_\_\_\_

Reviewed by \_\_\_\_\_ Date \_\_\_\_\_

EXHIBIT 3

IV-4



### ANALYSES OF INHERENT RISK

The second step in the vulnerability assessment process is the performance of an analysis, for each identified program and administrative function subject to these guidelines, of the inherent potential for waste, loss, unauthorized use, or misappropriation due to the nature of the activity itself. Matters to be considered in the analysis should include, but need not be limited to, the following:

- Purpose and characteristics
- Budget level
- Impact outside the agency
- Age and life expectancy
- Degree of centralization
- Special concerns
- Prior reviews
- Management responsiveness

#### Purpose and Characteristics

The purpose and characteristics of these program or administrative functions should be considered, and any aspects that make the activity susceptible to waste, loss, unauthorized use, or misappropriation noted. Knowledge of the purpose and characteristics can be obtained, if not already available, by reviewing such background material as the relevant enabling legislation and legislative history, regulations, statements of missions, goals and objectives, operating procedures and policies, and budget materials. The following matters should be noted, particularly since they often tend to contribute to fraud, waste and abuse:

- Broad or vague legislative authority or regulations.
- Cumbersome legislative or regulatory requirements.
- Broad or vague missions, goals or objectives.

- High degree of complexity.
- Existence of third party beneficiaries.
- Activities involving the payment of entitlement monies.
- Activities operating under severe time constraints.
- Activities involving the handling of cash receipts.
- Activities involving approval of applications, granting of authority, certifications, issuance of licenses or permits, inspections, or enforcement.

#### Budget Level

Programs or activities involving large amounts of money are susceptible to greater amounts of waste, loss, unauthorized use, or misappropriation than programs or activities involving small amounts. Accordingly, the level of funding, including personnel time allocated to the program or function, should be determined by reviewing the agency budget and supporting materials. For certain activities, the budget may not reveal the total money involved so estimates should be made and/or other financial measures considered. For example, for a function such as property management, a separate budget often does not exist. In order to measure the full financial significance of this function, the value of controlled property must be determined.

#### Impact Outside the Agency

Government programs and functions often have considerable financial and nonfinancial impact on persons and organizations outside the agency. For example, activities such as the issuance of registrations or permits, standard-setting, rate-making, and licensing can affect significantly economic status, health, safety, etc. When a program has such impacts, it may be susceptible to external pressures that might circumvent internal controls. Hence, impact outside the agency should be considered.

Information concerning potential impact can usually be obtained from such sources as budget documents, program descriptions, and media and public interest group reports.

### Age and Life Expectancy

Consideration should be given to the age and life expectancy of the program or administrative function. New (in existence less than two years), changing (undergoing substantial modification or reorganization), or phasing out (to be eliminated within 1 or 2 years) programs should be considered more susceptible to waste, loss, unauthorized use, or misappropriation than stable programs (in existence for more than two years and not expected to phase out within two years). The reasons are:

- New or changing programs may lack written policies or procedures, lack adequate resources, have inexperienced managers, lack devices to measure program performance, and in general have considerable confusion associated with them.
- Programs that are phasing out may lack adequate resources or may involve close-out activities for which controls have not been developed and/or large amounts of money or other resources which must be accounted for. Also, personnel often lose interest and motivation when a program is phasing out.

### Degree of Centralization

The extent to which the program or administrative function is conducted in a centralized or decentralized mode should be considered. Specifically, a determination should be made as to whether the activity is:

- Federal Centralized -- Managed and controlled on a day-to-day basis in a centralized Federal agency system.

- Federal Decentralized -- Managed and controlled on a day-to-day basis by Federal agency field installations or staffs.
- Participant Administered -- Managed and controlled on a day-to-day basis by a non-Federal organization. Programs supported by grants, contracts or loans would fall into this category.
- Other -- Managed and controlled on a day-to-day basis by some combination of the above or by other means.

Different degrees of centralization are appropriate for different types of activities. The evaluation should consider whether the degree of centralization is appropriate for the activity being conducted.

#### Special Concerns

Often, the existence of special concern for an activity may be indicative that for some reason it is highly susceptible to waste, loss, unauthorized use, or misappropriation, and should be treated as such. Consideration, therefore, should be given as to whether the program or administrative function has been the focus of the following types of special attention:

- Special interest exhibited by the President, Congress, OMB, or the Secretary.
- Deadlines set by legislation.
- Media attention.
- Litigation.

If special attention has been focused on the program or function, special problems related to its exposure to waste, loss, unauthorized use, or misappropriation may exist, and an attempt should be made to identify such problems. Also, consideration should be given as to whether the special attention given the program is, in and of itself, a source of pressure that might create a vulnerability.

#### Prior Reviews

Prior audit reports submitted by the Inspector General, the General Accounting Office, and others; internal evaluations; Congressional reports; and consulting reports should be reviewed for any indications that the program or administrative function has previously been subject to losses due to waste, loss, unauthorized use, or misappropriation. The amounts of estimated losses, if any, and the period covered by the prior review should be considered.

Programs or functions with minimal audit coverage or with significant and repeated findings should be considered more susceptible to waste, loss, unauthorized use, or misappropriation.

#### Management Responsiveness

Management's responsiveness to recommendations from its OIG, GAO, and other evaluation groups should be considered. This would include actions taken to correct problems brought to management's attention as a result of prior reviews. A lack of responsiveness suggests a higher degree of susceptibility to waste, loss, unauthorized use, or misappropriation.

\* \* \* \* \*

The list of control objectives contained in Appendices B and B-1 may be useful in identifying certain risks that should be considered for each of the programs and functions being assessed.

#### PRELIMINARY EVALUATION OF SAFEGUARDS

The third step in the vulnerability assessment process is the making of a preliminary judgment regarding the existence and adequacy of internal control over the specific programs and administrative functions subject to the guidelines. The key consideration should be whether appropriate controls are in place to prevent or at least minimize waste, loss, unauthorized use, or misappropriation.

As stated, an in-depth review of the existing controls is not appropriate at this stage. Rather, the evaluator's judgment should be based largely on his or her knowledge of the existence and functioning of safeguards that protect the activity's resources from waste, loss, unauthorized use, or mismanagement. However, the evaluation must be thoughtful and based on a working knowledge of the program or administrative function. Judgments made without knowledge of the situation are usually not sufficiently reliable.

#### SUMMARIZING THE RESULTS OF THE VULNERABILITY ASSESSMENTS

The completion of the three steps permits the assessor to make an overall assessment of (1) the adherence of the program or administrative function's internal control system to at least some of the prescribed internal standards, and (2) the vulnerability of the program or administrative function itself. The assessment should be documented (see Exhibits 4 and 5 for suggested forms) and a conclusion reached as to overall vulnerability. Care should be taken to ensure that the ratings, which can be a subjective judgment or a numerical score, are done consistently throughout the entire organization.

Agency Component: \_\_\_\_\_

Assessment of Compliance with Standards of Internal Control  
Based on Completion of a Vulnerability Assessment

Program/Administrative Function -- \_\_\_\_\_

<u>Standard</u>	<u>Compliance</u> (Yes, No, N/A)	<u>Comments</u>
Reasonable assurance		
Attitude		
Competent personnel		
Internal control objectives*		
Internal control techniques*		
Documentation		
Recording of transactions*		
Execution of transactions*		
Separation of duties		
Supervision		
Access to Resources		

OVERALL COMMENTS: \_\_\_\_\_

Prepared by \_\_\_\_\_ Date \_\_\_\_\_

Reviewed by \_\_\_\_\_ Date \_\_\_\_\_

\*NOTE: Sufficient analysis will probably not have been done at this point to support an assessment of compliance with those standards marked with an asterisk. If that is true, mark N/A (not applicable) in the second column.

EXHIBIT 4

IV-11

Agency Component: \_\_\_\_\_

Overall Vulnerability Assessment

Program/Administrative Function -- \_\_\_\_\_

OVERALL EVALUATION OF GENERAL CONTROL ENVIRONMENT: \_\_\_\_\_

ANALYSIS OF INHERENT RISK:

<u>Factor</u>	<u>Rating</u>	<u>Comments</u>
Purpose and Characteristics		
Budget Level		
Impact Outside the Agency		
Age and Life Expectancy		
Degree of Centralization		
Special Concerns		
Prior Reviews		
Management Responsiveness		
Other Factors		

OVERALL EVALUATION OF INHERENT RISK: \_\_\_\_\_

PRELIMINARY EVALUATION OF SAFEGUARDS: \_\_\_\_\_

OVERALL VULNERABILITY: \_\_\_\_\_

OTHER COMMENTS (PROBLEMS REQUIRING IMMEDIATE ACTION, DEFICIENCIES NOTED, ETC.) \_\_\_\_\_

Internal Control Review Scheduled For \_\_\_\_\_

To be Performed By: \_\_\_\_\_

Prepared by \_\_\_\_\_ Date \_\_\_\_\_

Reviewed by \_\_\_\_\_ Date \_\_\_\_\_

EXHIBIT 5

IV-12



Problems or weaknesses requiring immediate corrective action may be observed during the performance of the vulnerability assessments. For instance, a program may be assessed in which the controls are perceived to be grossly inadequate and there is a strong possibility of loss if corrective action is not taken immediately. Such situations should be brought to the attention of the appropriate agency official as soon as possible in order that appropriate corrective actions can be taken promptly.

#### DEVELOP PLAN FOR SUBSEQUENT ACTIONS

The next step in the process is to use the summarized vulnerability assessments to determine appropriate subsequent actions. It is important at this point to remember the overall objective of the internal control evaluation process, namely, to bring about a strengthening of internal control systems in a cost-effective manner.

One approach may be to classify the vulnerability of each of the programs and administrative functions subject to these guidelines in such a way as to facilitate the establishment of a prioritized schedule for internal control reviews, e.g., highly vulnerable, requiring a detailed review of internal controls; moderately vulnerable, permitting less intensive and less frequent internal control reviews; low vulnerability, etc.

Another approach would be to consider a series of options for each of the program and administrative functions. This could be done by first evaluating the degree and causes of the vulnerabilities; then considering management priorities, resource availability, and other management initiatives underway; and finally determining the appropriate courses of action. These might consist of:

- Scheduling and conducting an internal control review.
- Requesting an audit.
- Establishing increased or improved monitoring procedures.
- Developing and conducting training programs for the staff.
- Issuing clarifying instructions.
- Modifying procedures or documents.

An approach such as the latter can help to ensure that resources devoted to the internal control evaluation and improvement process are used in an effective and efficient manner.

## CHAPTER V

### INTERNAL CONTROL REVIEWS

An internal control review is a detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner.

Six recommended steps for an internal control review are:

- Identification of the event cycles.
- Analyses of the general control environment.
- Documentation of the event cycle.
- Evaluation of the internal controls within the event cycle.
- Testing of the internal controls.
- Reporting the results.

This Chapter describes how to perform these six steps.

### IDENTIFICATION OF THE EVENT CYCLES

Event cycles are the processes used to initiate and perform related activities, create the necessary documentation, and gather and report related data. In other words, an event cycle is a series of steps taken to get something done. Each program and administrative function performed within an agency or agency component contains one or more event cycles. For example, an entitlement program could contain the following event cycles: information gathering and verification, eligibility determination, information processing and record keeping, payment, and monitoring. The event cycles for an administrative function could include payroll, procurement of supplies and materials, correspondence handling, etc. (Appendices B and B-1 present event cycles commonly found in Federal Government agencies. The General Accounting Office, professional associations, and private organizations also publish lists of common event cycles).

Event cycles provide the focal points for the conduct of internal control reviews. Accordingly, the first step in the internal control review phase is to identify the event cycles in the program or administrative function which are subject to the guidelines and which are selected for an internal control review. The sources of information for developing such a list would be Appendix B or similar lists, the vulnerability assessment for the program/function, legislation, regulations, policy statements, procedures manuals, management interviews, etc. Exhibit 6 provides a form on which the cycles can be listed.

A determination must then be made as to which event cycles are to be reviewed. The results of the vulnerability assessment should be helpful in making this determination, with areas identified as the cause of a highly vulnerable classification being given the highest priority. Documentation should be maintained.

Agency Component: \_\_\_\_\_

List of Event Cycles Within Programs  
and Administrative Functions

Program/Administrative Function - \_\_\_\_\_

Event Cycles	Comments

Prepared by \_\_\_\_\_ Date \_\_\_\_\_

Reviewed by \_\_\_\_\_ Date \_\_\_\_\_

EXHIBIT 6

V-3

### ANALYSIS OF THE GENERAL CONTROL ENVIRONMENT

The environment in which the cycle operates has a major impact on the effectiveness of internal control. Therefore, an important part of an internal control review is an evaluation of the general control environment, i.e., the management attitude, organization structure, personnel, delegation and communication of authority and responsibility, policies and procedures, budgeting and reporting practices, organizational checks and balances, etc. Analysis of the general control environment performed for the vulnerability assessment can be referred to and updated.

### DOCUMENTATION OF THE EVENT CYCLE

The next step is to document the event cycle in order to obtain a thorough understanding of how it operates. This is accomplished by interviewing the persons involved in the cycle, reviewing existing documentation, observing the activity, and then preparing either a narrative explanation or a flow chart, accompanied by pertinent narrative information in sufficient detail to permit an in-depth analysis of the existence and adequacy of internal controls. The documentation should identify such things as the procedures, the personnel performing the procedures, and the forms and records developed and maintained.

Regardless of the method used, it is advisable to review the completed documentation with the persons providing the information, and, if necessary, track one or two transactions through the process. Both procedures will assure that the documentation and the understanding of the cycle are accurate.

#### EVALUATION OF THE INTERNAL CONTROLS WITHIN THE EVENT CYCLES

The fourth step in the process is to evaluate the event cycle by reviewing the documentation and deciding whether the system, at least as defined, is sufficient to provide reasonable assurance that obligations and costs are in compliance with applicable law; the agency's funds, property, and other assets are properly safeguarded; and the revenues and expenditures are properly recorded to permit the preparation of reliable financial and statistical information. The manner in which this is done is to:

- Ascertain the control objectives for the event cycle. Control objectives are desired goals or conditions for a specific event cycle that reflect the application of the overall objectives of internal control to that specific cycle. If control objectives are achieved, the potential for the occurrence of waste, loss, unauthorized use, or misappropriation is significantly decreased.

The control objectives for an event cycle should be written. This documentation should be reviewed to determine whether the list of objectives for each event cycle is complete, logical, and relevant to the event cycle. If the control objectives are not adequately documented, such documentation should be developed and maintained as part of the overall documentation of internal controls.

- Examine the documentation and ascertain whether appropriate internal control techniques are in place to enable the control objectives to be met in an efficient and effective manner. Internal control techniques are the processes or documents that enable the control objectives to be achieved.

Control techniques should be defined in writing. This documentation should be reviewed to determine whether it provides reasonable assurance that the control objectives can be met in a consistent, efficient, and effective manner. If the control techniques are not adequately documented, such documentation should be developed and maintained as part of the overall documentation of the internal controls.

The relationship between this and the prior task and the inherent risks in an event cycle cannot be overemphasized. Control objectives are established because a risk exists; internal control techniques are implemented to prevent the specific risk from occurring. For example, a payroll system contains the risk of people getting paid for time not worked. An appropriate control objective would be that payments are made only in return for services. An internal control technique could be that time sheets include approval by a supervisor that the payment made is only for services actually performed.

It is important to remember that there are inherent limitations that can constrain an agency's efforts to maintain effective internal control. Examples include budget constraints, statutory or regulatory restrictions, staffing limitations, and other priorities. These constraints should be considered when evaluating the appropriateness of the control objectives and internal control techniques.

- Identify whether there are any internal control techniques that are excessive, thereby creating inefficiencies and unnecessary costs.



A form that may be useful in documenting this information is presented in Exhibit 7. Appendices B and B-1 presents appropriate control objectives for common event cycles. Similar lists can be obtained from the General Accounting Office, professional associations, and private organizations' publications.

The results of this process are an identification of (a) necessary internal control techniques (whose functioning has to be tested, as discussed in the next section); (b) control objectives for which the control techniques are not adequate and system corrections must be made; and/or (c) control techniques that are unnecessary and can be eliminated.

### TESTING OF THE INTERNAL CONTROLS

The final step in an internal control review is the testing of the necessary control techniques to determine whether such controls are functioning as intended. This may be done by selecting a sample of transactions and reviewing the documentation for those transactions, as well as making other observations and inquiries, and ascertaining whether the specified techniques are satisfactorily employed. Various sampling procedures may be useful for enhancing the effectiveness of this process. The testing of the ADP systems may often require the use of advanced review procedures.

Sometimes a specified control technique will appear to be inadequate for a given condition or will not be functioning properly. In those instances, the reviewer should evaluate whether personnel are compensating for the shortcoming with other safeguards, or whether compensating controls exist in interrelated systems not subject to review.

The reviewer should complete this testing step by noting any necessary control techniques not functioning as intended or not compensated for. He should also consider how such shortcomings should be addressed, i.e., by instituting new controls, improving existing controls, or accepting the risk associated with the shortcoming. A form for such notations is presented in Exhibit 8.

Agency Component: \_\_\_\_\_

List of Internal Controls

Program/Administrative Function - \_\_\_\_\_

Event Cycle \_\_\_\_\_

Control Objectives	Control Technique	Strength (S) Weakness (W) Excessive (E)	Comments

Prepared by \_\_\_\_\_

Date: \_\_\_\_\_

Reviewed by \_\_\_\_\_

Date: \_\_\_\_\_

EXHIBIT 7

V-8

Agency Component: \_\_\_\_\_

Tests of Internal Controls

Program/Administrative Function - \_\_\_\_\_ Event Cycle \_\_\_\_\_

Necessary Control Techniques	Functioning (Yes or No)	Adequate (Yes or No)	Comments and Recommendations

Prepared by \_\_\_\_\_

Date \_\_\_\_\_

Reviewed by \_\_\_\_\_

Date \_\_\_\_\_

EXHIBIT 8

V-9

### REPORTING THE RESULTS OF THE INTERNAL CONTROL REVIEWS

Two types of reports should result from the internal control reviews. The first are the reports for initiating corrective action, prepared for the managers of the programs and administrative functions and other line managers. These reports, which may be written or oral, are discussed in the remainder of this chapter. The second type of report, discussed in the next chapter, is necessary to support the agency head's statement to the President and the Congress.

Reports intended to obtain corrective action should contain an identification of weaknesses within the system and recommendations as to how the weaknesses can be corrected. Recommendations for possible improvements in the economy and efficiency of the internal controls should also be made, if appropriate.

More specifically, attention should be given to the following:

- In what ways is the general control environment inadequate to provide the necessary atmosphere for the appropriate functioning of specific controls?
- In what areas are necessary control techniques nonexistent or inadequate?
- In what areas are necessary control techniques not functioning as intended?
- In what areas are control techniques excessive, thereby fostering a lack of economy or creating inefficiencies?

- In what ways are executive, legislative, or other management requirements excessive, thereby creating inefficiencies?

These reports should include recommendations for how such situations could be corrected or improved. In evaluating possible alternatives, consideration should be given to the costs and expected benefits of changes in order that control objectives can be achieved in a cost-effective manner. While it is sometimes difficult to determine the exact costs and benefits of suggested improvements, it is desirable at least to estimate these amounts so that controls are not instituted that cost more than they save.

#### FOLLOW-UP ACTIONS

Vulnerability assessments and internal control reviews and reports should not be an end in themselves. The recommendations should be considered by management on a timely basis and the appropriate corrective actions taken as promptly as possible. A formal follow-up system should be established that logs and tracks recommendations and target dates, provides assistance for the development of plans for implementation of the corrections, and monitors whether the changes are made as scheduled. The existing audit follow-up system could be used for this purpose.

## CHAPTER VI

### REPORTING UNDER THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

The Federal Managers' Financial Integrity Act of 1982 requires a statement from each agency head to the President and to the Congress as to whether the agency has established a system of internal accounting and administrative control in accordance with standards prescribed by the Comptroller General; and whether this system provides reasonable assurance that:

- Obligations and costs are in accordance with applicable law;
- Funds, property and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Revenues and expenditures are properly recorded and permit the preparation of reliable financial and statistical reports.

An agency that follows these guidelines will be able to comply with the Act.

#### BASIC STATEMENT

Specifically, an agency following these guidelines will have the following in place:

- Responsibility for directing a program to comply with the Act assigned to a high level official.

- Agency internal control directives, regulations and other materials published and disseminated throughout the organization.
- Documentation of the conduct and results of ongoing vulnerability assessments and internal control reviews.
- Documentation of corrective actions taken to strengthen the internal control systems.
- Inclusion of internal control elements in performance appraisals.
- Written assurances from the designated senior official responsible for coordinating the agencywide effort and the heads of the agency's various organizational units, and comments from the Inspector General or equivalent. (See Appendices C, D, and E for examples)

The existence of these elements, collectively, provides strong evidence that management and other personnel, throughout the organization, are cognizant of the importance of internal control and that the necessary evaluation and improvement processes are taking place. These are the two major conditions that support transmittal of the required statement.

#### MATERIAL WEAKNESSES

The Act also requires an agency to include within the statement to the President and the Congress a report listing identified material weaknesses in internal accounting and administrative control and a schedule for their correction. A material weakness is a situation in which the designed procedures or the degree of operational compliance therewith does not provide reasonable assurance that the objectives of internal control specified in the Act are being accomplished. The size of the agencies and the complexities of their activities are such that even though the elements listed in the previous section are present, material weaknesses, as defined, could exist.

Another step, therefore, in preparing the statement to the President and the Congress is for the senior official responsible for coordinating the agencywide effort to use the internal reporting system described in Chapter II to determine whether any material weaknesses in internal accounting and administrative control of significance to the President and the Congress were uncovered by the evaluation process. If there were, a brief description should be obtained along with the plans and schedule for correcting the weakness. This information would be incorporated into the report.

Finally, the report can and should be used to demonstrate that the planned corrective actions have been taken. This can be done by including in the statement the status of actions taken to correct weaknesses in internal accounting and administrative control identified in prior years' statements.

#### CLASSIFIED MATTERS

The statement must also be made available to the public. However, relevant information that is (1) specifically prohibited from disclosure by any provision of law; or (2) specifically required by Executive order to be kept secret in the interest of national defense or the conduct of foreign affairs, should not be included in the statement made available to the public.

\* \* \* \* \*

A recommended statement format is provided in Appendix F.



## GLOSSARY

Agency -- Any executive department or independent establishment in the Executive branch of the Government but not including any Government corporation or agency subject to the Government Corporation Control Act, nor the United States Postal Service.

Agency Component -- A major organization, program, or functional subdivision of an agency having one or more separate systems of internal control.

Assessable Unit -- A program or administrative function or subdivision thereof which is to be the subject of a vulnerability assessment.

Control Objective -- A desired goal or condition for a specific event cycle that reflects the application of the overall objectives of internal control to that specific cycle.<sup>1/</sup>

Event Cycle -- The processes used to initiate and perform related activities, create the necessary documentation, and gather and report related data.

1/ Control objectives are not absolutes. Since the achievement of control objectives can be and is affected by such factors as budget constraints, statutory and regulatory restrictions, staff limitations, and cost-benefit considerations, the lack of achievement of control objectives does not necessarily represent a defect or deficiency in internal control.

General Control Environment -- Various environmental factors that can influence the effectiveness of internal controls over program and administrative functions.

Inherent Risk -- The inherent potential for waste, loss, unauthorized use, or misappropriation due to the nature of an activity itself.

Internal Control -- The steps that an agency takes to provide reasonable assurance that obligations and costs are in compliance with applicable law; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

Internal Control Review -- A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner.

Internal Control System -- The sum of the organization's methods and measures used to achieve the objectives of internal control.

Internal Control Technique -- A process or document that is being relied on to efficiently and effectively accomplish a control objective and thus help safeguard an activity from waste, loss, unauthorized use, or misappropriation.

Material Weakness -- A situation in which the designed procedures or degree of operational compliance therewith does not provide reasonable assurance that the objectives of internal control specified in the Act are being accomplished.

Vulnerability Assessment -- A review of the susceptibility of a program or function to the occurrence of waste, loss, unauthorized use, or misappropriation.

APPENDIX ASAMPLE PARTIAL INVENTORY OF COMPONENTS,  
PROGRAMS, AND ADMINISTRATIVE FUNCTIONS

This appendix illustrates an approach that a department/agency might use to inventory its components and programs and administrative functions for purposes of conducting vulnerability assessments. The example is based on operations of the Department of Commerce.

<u>Component (1)</u>	<u>Program and Administrative Function (2)</u>
Patent and Trademark Office	Patent process Trademark process Information dissemination Administration
National Bureau of Standards	Measurement, research, and standards Engineering measurements and standards Computer sciences and technology Central technical support Administration
National Technical Information Service	6
Bureau of the Census	6
Office of Administration	Program planning and personnel Information and resource management Operations/general services Controller's office activities
Office of the Inspector General	Audit Investigative Policy and planning
Office of General Counsel	6
Office of Public Affairs	6
Office of Congressional Relations	6

(1) This is a partial listing. Other bureaus would also be included as individual components.

(2) Programs and administrative functions have only been included for a few components. In actual use programs and administrative functions for the other components would also be listed.

APPENDIX B

COMMON EVENT CYCLES AND SUGGESTED CONTROL OBJECTIVES

IN FEDERAL AGENCIES

This appendix presents a list of event cycles commonly found in Federal agencies and agency components. Also included are certain types of assets that are highly susceptible to loss and for which controls are vital, e.g., cash, materials and supplies. Finally, the list provides suggested control objectives for each event cycle/type of asset.

The purpose of the list is to help agencies and agency components identify the event cycles and types of assets and control objectives that need to be considered when performing internal control reviews. The list is neither all-inclusive nor mandatory. Agencies will probably operate event cycles not included on the list and certainly will not operate all cycles included in the list. Also, internal control objectives listed may not be appropriate for a particular situation. Accordingly, each agency should use this list as a guide to identify event cycles and develop internal control objectives for its programs and administrative functions that are covered by these guidelines. (Similar lists are available from the General Accounting Office, professional associations, and private organizations.)

Finally, in establishing control objectives and control techniques, as well as in performing internal control reviews, agencies should be mindful of the inherent limitations (budget constraints, statutory and regulatory restrictions, staffing limitations, etc.) which constrain agency action. The lack of achievement of control objectives due to these systemic limitations or cost-effectiveness considerations cannot and should not be considered defects or deficiencies in internal controls.

#### I. OPERATIONS CYCLES

The operations cycles are intended to encompass the agency's program activities that are subject to these guidelines. The differences in agency missions make it impossible to develop a representative list of operations cycles and corresponding control objectives. Hence, each agency/agency component should examine its own programs and define the appropriate event cycles and control objectives.

The following are the operations cycles for some typical government programs and the internal control objectives for these cycles.

##### Production Activities

The primary internal control objectives normally associated with production activities include the following:

- (1) A production plan is authorized defining the products to be manufactured, the timing and quantities of production, and the needed inventory levels.
- (2) Lead time schedules are timely and accurate, and permit realistic due dates.
- (3) Product quality and engineering standards exist and are monitored to ensure that quality products are produced as efficiently as possible.

- (4) Production controls exist to ensure that the plant is operating with the optimum mix of resources including labor, equipment, and materials.
- (5) Production controls exist to prevent the manufacture of unauthorized products or quantities of products.
- (6) Resources used and products completed are timely and accurately reported.
- (7) Production costs are computed accurately and recorded timely.
- (8) Recorded balances of inventory, property, and related activity are periodically substantiated and evaluated.

#### Loans and Loan Guaranties

The primary internal control objectives normally associated with loans and loan guaranties include the following:

- (1) Applications for loans and loan guaranties are evaluated for appropriateness of eligibility, collateral, if required, and other qualifying criteria prior to approval.
- (2) Security interest in property used as collateral is properly recorded, filed, and documents secured by a responsible custodian.
- (3) Accurate receivables agings are prepared systematically and timely.
- (4) Loan and loan guaranty repayments are collected, controlled and reported in a manner that is consistent with applicable appropriations, other law, and policy.
- (5) Periodic estimates are made of uncollectible loan balances with such estimates timely reported to management.
- (6) Proper write-off, conversion, and settlement or forgiveness of delinquent loans is assured.

### Grants

The primary internal control objectives normally associated with grants include the following:

- (1) Accurate maintenance of the factors used in distribution formulas for entitlement grants.
- (2) Grantees' program eligibility requirements are sufficiently detailed to ensure that the program beneficiaries and other interested parties understand the qualifications to receive prescribed benefits.
- (3) Grantees maintain sound organizational, budgetary and accounting systems that are periodically reviewed and evaluated.
- (4) Grantees' procurement procedures comply with regulations.
- (5) Grantees properly maintain, safeguard, and account for government-financed property and equipment.
- (6) Grantees maintain current cost allocation plans and overhead rates.
- (7) Grantees are paid only for allowable costs and amounts.
- (8) Financial and compliance audits of grantee activity performed at least once every two years.
- (9) Prompt and appropriate grant close-out actions are taken.

## II. INTERNAL MANAGEMENT AND ADMINISTRATION CYCLES

### Organization

The primary internal control objective normally associated with organization includes the following:

- (1) Responsibility for the performance of all duties is specifically assigned and appropriately separated along with necessary delegations of authority to sufficient numbers of qualified employees.



### Personnel Policies and Practices

The primary internal control objectives normally associated with personnel policies and practices include the following:

- (1) Personnel ceilings are strictly enforced.
- (2) Recruitment, training, evaluation, and termination practices are operating in accordance with applicable laws and regulations and in a manner that promotes economy and efficiency of operations.
- (3) Appropriate standards of conduct are communicated and enforced.
- (4) Employment records are promptly, completely and accurately established with proper safeguards against unauthorized access or the preparation of fictitious records.

### Administrative Support Services

The primary internal control objectives normally associated with administrative services include the following:

- (1) Services provided meet the organization's legitimate needs.

- (2) Services are conducted in a manner that promotes economy and efficiency in operations.
- (3) Safeguards exist to prevent unauthorized or wasteful use of such services.

(See Appendix B-1)

#### Advisory and Technical Services

The primary internal control objectives normally associated with advisory and technical services include the following:

- (1) Services provided meet the organization's legitimate needs.
- (2) Services are conducted in a manner that promote economy and efficiency in operations.
- (3) Safeguards exist to prevent unauthorized or wasteful use of such services.

#### Security and Safeguarding of Classified Material

The primary internal control objectives normally associated with security and safeguarding classified material are the following:

- (1) Documents are appropriately classified.
- (2) Appropriate safeguards exist to prevent unauthorized access to classified materials.

### Audit Followup

The primary internal control objectives normally associated with audit followup include the following:

- (1) Audit resolution and corrective actions pertaining to audit recommendations are made on a timely basis.
- (2) Audits resolved and corrective action on audit recommendations are scheduled in accordance with specific criteria.
- (3) Accurate records of the status of audit reports and recommendations are maintained through the entire process of resolution and corrective action.
- (4) Major disagreements between the audit organization and agency management or contracting officials are resolved on a timely basis.
- (5) Resolution actions are consistent with law, regulation, and Administration policy.
- (6) Resolution and correction action on recommendations involving more than one program, agency, or level of government are coordinated.
- (7) Required reports are reliable, accurate, and submitted on a timely basis.
- (8) Claims arising from audit disallowances are promptly recorded as receivables and collected in accordance with the Federal Claims Collection Act.
- (9) Interest on audit-related debt is charged promptly, without regard to whether the disallowance is or will be appealed.

### III. INFORMATION PROCESSING AND REPORTING CYCLES

#### Information Collection

The primary internal control objectives normally associated with information collection are the following:

- (1) Information collected is meaningful and useful.
- (2) Information collected is reliable.
- (3) Information is arranged in an orderly fashion.
- (4) Information is maintained on a current basis.

#### Correspondence Handling

The primary internal control objectives normally associated with correspondence handling are the following:

- (1) Correspondence is channeled to the appropriate parties.
- (2) Replies are made promptly, accurately and responsively.

#### Records Maintenance

The primary internal control objectives normally associated with records maintenance are the following:

- (1) Records are readily available.
- (2) Records are adequately protected.
- (3) Only necessary records are retained.

#### Automatic Data Processing

The primary internal control objectives normally associated with automatic data processing are as follows:

- (1) Proper authorization of transaction inputs, adequate edit checks, and necessary safeguards of sensitive input forms to insure accurate, proper, complete and timely entry of information.
- (2) Data is safeguarded to prevent unauthorized access, improper changes, or loss.
- (3) Appropriate controls exist to detect unauthorized use of the system.
- (4) Outputs produced accurately, completely and timely.

#### IV. ASSET AND LIABILITY CYCLES

##### Cash

The primary internal control objectives normally associated with cash include the following:

- (1) Physical security safeguards maintained where cash is stored and processed.
- (2) Cash, check signing machines, signature dies, and blank, partially prepared, mutilated, and voided checks are protected from unauthorized use.
- (3) Receipts are recorded properly and timely and deposited promptly.
- (4) Disbursements are recorded properly and timely.
- (5) Effective cash management system is maintained.

##### Negotiable Instruments and Other Investments

The primary internal control objectives normally associated with negotiable instruments and other investments include the following:

- (1) Physical security safeguards are maintained where negotiable instruments and other investments are stored and processed.
- (2) Bonds, drafts, and other securities are protected from unauthorized use.

- (3) Timely and accurate accounting is maintained.
- (4) Investments comply with legal requirements.
- (5) Interest and other investment income is collected promptly when due.

#### Letters of Credit

The primary internal control objectives normally associated with letters of credit include the following:

- (1) Letters of credit are issued only to large dollar recipients who have a continuing relationship with the Federal Government and an adequate cash management system.
- (2) Amounts available under letters of credit do not exceed available award authority or immediate cash needs.
- (3) Assurance exists that funds are used only for intended purpose.
- (4) Cash balances in recipients' hands do not exceed recipients' needs.

#### Receivables

The primary internal control objectives normally associated with receivables include the following:

- (1) Prompt and accurate recording of all receivables.
- (2) Ability to determine and report sources and age of receivables.
- (3) Continuous and timely attempts are made to collect receivables due.
- (4) Identification of the portion of the receivables that may not be collectible.
- (5) Validity of write-offs, conversions, and settlement or forgiveness of receivables.
- (6) Repayments collected, controlled and reported in a manner consistent with applicable law and regulations.
- (7) Title to property used as collateral is properly recorded, filed, and secured.

### Capital Assets and Material Inventories

The primary internal control objectives normally associated with capital assets and material inventories include the following:

- (1) Only authorized and needed property is procured.
- (2) Receipts of property are recorded timely and accurately in source documents and accounting records.
- (3) Detailed subsidiary records are maintained for individual capital assets and significant categories of material inventories and are periodically reconciled to control accounts.
- (4) Periodic physical verification is made of the existence and condition of property and inventories.
- (5) Physical security measures are commensurate with the size, type, and value of property.
- (6) Issues, transfers, retirements, and losses are reported and accounted for timely.
- (7) Assets are properly requisitioned and used exclusively for government activities.
- (8) Records of asset use are accurately maintained.

### Payables, Debt, and Other Liabilities

The primary internal control objectives normally associated with payables, debt, and other liabilities include the following:

- (1) All payables and other claims against the Government are recorded promptly and accurately.
- (2) Prepayment examinations and certifications of performance are made to ensure validity and clerical accuracy of claims prior to payment.
- (3) Debt and other long-term liabilities are properly authorized, recorded and serviced in accordance with applicable laws and regulations.

#### Fiduciary and Trust Funds

The primary internal control objectives normally associated with fiduciary and trust funds include the following:

- (1) Liabilities to others are recorded properly.
- (2) Detailed subsidiary records are maintained and are periodically reconciled to control accounts.
- (3) Funds are handled in accordance with applicable law and regulations.
- (4) Effective control is maintained by responsible officials.
- (5) Benefits and other disbursements are subject to comparable controls to other payments.

#### V. RECEIPTS CYCLES

##### Taxes and Duties

The primary internal control objectives normally associated with taxes and duties include the following:

- (1) Taxing programs are applied to all individuals and organizations subject to taxes.
- (2) Tax returns and assessments are reasonably correct.
- (3) All receipts are recorded accurately and timely.
- (4) Receipts are safeguarded while in the custody of the agency and promptly transferred to the Treasury.
- (5) Settlements, allowances, and refunds are properly authorized.
- (6) Taxing programs are administered in accordance with applicable laws and regulations.

##### Services Rendered

The primary internal control objectives normally associated with services rendered include the following:



- (1) Revenues are recorded immediately as services are rendered with accounts receivable promptly set up and billed on a timely basis if not paid in full.
- (2) Receipts are recorded accurately and timely.
- (3) Receipts are safeguarded while in the custody of the agency and promptly transferred to the Treasury.
- (4) Services rendered and related charges are conducted in accordance with applicable laws and regulations.

#### Other Sales

The primary internal control objectives normally associated with other sales include the following:

- (1) Sales are recorded immediately as items are sold with accounts receivable promptly set up and billed on a timely basis for non-cash sales.
- (2) Receipts are recorded accurately and timely.
- (3) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.
- (4) Sales of goods, property, equipment, bonds, notes, and other items are conducted in accordance with applicable laws and regulations.

#### Fines, Penalties, and Judgments

The primary internal control objectives normally associated with fines, penalties, and judgments include the following:

- (1) Fines, penalties, and judgments are levied on or sought from individuals and organizations as required by laws or regulations.
- (2) Fines and penalties are charged at the proper statutory rate.

- (3) All receipts are recorded accurately and timely.
- (4) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.
- (5) Rescissions and forgivenesses are properly authorized.

#### Other Receivable Collections

The primary internal control objectives normally associated with other receivable collections include the following:

- (1) All receipts are recorded accurately and timely.
- (2) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.
- (3) Procedures for effecting collection, including offset and installment payments, are utilized on a timely basis.

#### Other Receipts

The primary internal control objectives normally associated with other receipts include the following:

- (1) All receipts are recorded accurately and timely.
- (2) Receipts are safeguarded while in the custody of the agency and are promptly transferred to the Treasury.
- (3) Monies are requested and received in situations where warranted in accordance with applicable law and regulations.

### VI. EXPENDITURE CYCLES

#### Payroll, Pensions and Other Fringe Benefits

The primary internal control objectives normally associated with payroll, pensions and other fringe benefits include the following:

- (1) Appropriate authority exists for the appointment, change, and termination of all personnel.
- (2) Compensation and benefit payments are in accord with current statutory or regulatory limitations.
- (3) Payments are made only in return for services rendered.
- (4) Gross and net payroll amounts and payroll deductions are correct.
- (5) Payroll charges, including fringe benefits, are recorded and distributed promptly.
- (6) Timely, accurate and complete subsidiary records are maintained of vacation, sick leave and other balances.

Federal Assistance Payments to Other Governmental Units and  
Individuals

The primary internal control objectives normally associated with Federal assistance payments to other governmental units and individuals include the following:

- (1) Disbursements are valid and properly approved.
- (2) Disbursements are recorded promptly and accurately to the appropriate accounts.
- (3) Payments are within budget limits and in accordance with applicable laws, regulations, and agreements.
- (4) Payments are made only to eligible recipients for eligible costs.
- (5) Payments are made promptly and in full.

Procurement and Acquisition

The primary internal control objectives normally associated with procurement and acquisition include the following:

- (1) All purchases are authorized within budget limits and made in accordance with applicable laws, regulations, and agreements.

- (2) Government has paid lowest prices commensurate with quality, service, delivery and reliability.
- (3) Purchases and acquisitions are received and examined for acceptability.
- (4) Disbursements are valid and properly approved.
- (5) Disbursements are made on a timely basis.
- (6) Disbursements are recorded promptly and accurately to the appropriate account.

#### Travel Advances and Reimbursements

The primary internal control objectives normally associated with travel advances and reimbursements include the following:

- (1) Travel reimbursements and advances provided only for properly authorized travel .
- (2) Amounts paid are in accordance with applicable government travel regulations.
- (3) Reimbursements are timely, properly approved, and properly recorded to the appropriate account.
- (4) Advances are liquidated within reasonable time periods.

#### Other Expenditures

The primary internal control objectives normally associated with other expenditures include the following:

- (1) Expenditures are valid and properly approved.
- (2) Expenditures are recorded promptly and accurately in the appropriate accounts.
- (3) Debt service requirements, refunds, valid claims and other appropriate payments are made timely in full accordance with applicable laws, regulations, and agreements.

APPENDIX B-1

SUGGESTED CONTROL OBJECTIVES FOR SELECTED ADMINISTRATIVE  
SUPPORT SERVICES

Included in Appendix B are suggested control objectives for the generic category administrative support services. The Office of Management and Budget has developed a series of model control systems for specific administrative support services. This Appendix presents suggested control objectives for selected administrative services drawn from those control models.

Periodicals, Pamphlets, and Audiovisual Products

- Periodicals, pamphlets, and audiovisual products are related to agency mission, contribute to solution of an identifiable need, and are appropriate in format and scope for the intended audience.
- Periodicals, pamphlets, and audiovisual products are not duplicative of other materials that convey the same message.
- Periodicals, pamphlets, and audiovisual products are produced or acquired in a cost-effective manner.
- Completed periodicals, pamphlets and audiovisual products are consistent with planned product and distributed in conformance with approved distribution plan.

### Consulting and Related Services

- Services are secured for an appropriate purpose, i.e., to obtain specialized opinions or professional or technical advice which does not exist or is not available within the agency or another agency, outside points of view to avoid excessively limited judgments on critical issues, advice regarding developments in industry, university, or foundation research, opinion of noted experts whose national or international prestige can contribute to the success of important projects, or assistance to complete a necessary project within a specified period of time.
- Services are not used to perform work of a policy/decision-making or managerial nature that is the direct responsibility of agency officials; or to bypass or undermine personnel ceilings, pay limitations, or competitive employment procedures; or to aid in influencing or enacting legislation.
- Services are secured through maximum competition, without preference to former government employees.
- Payments for services bear a relation to work completed.
- Services provided meet the organization's specific needs and advice and recommendations are implemented, unless there are valid reasons to the contrary.

### Long-Term Training

- Long-term training is provided only when the necessary set of knowledges or skills requires a comprehensive study program which cannot be accomplished by a series of unconnected short-term courses; the time span for the acquisition of the knowledge or skill is such that a concentrated or long-term program is most feasible; and the set of knowledges or skills is so complex, new, or unique that it cannot be readily obtained on a short-term basis or through other means.

- Nominees continue in agency service for an appropriate period following completion of long-term training.
- Long-term training is relevant to selected employees' current and/or projected assignments, required skills and knowledge, individual development plan, and career potential; and is appropriate for his or her commitment to the organization and Federal service.

#### Space Acquisition and Utilization

- Need for and intended use of space is adequately justified.
- Requesting unit conforms with space allowance standards.
- Request cannot be met by realignment of existing space assignments or use of vacant or under-utilized space.
- Space is leased on the most favorable basis to the Government, with due consideration to maintenance and operational efficiency.
- Lease charges are consistent with prevailing scales in the community for comparable facilities.
- Legal requirements, e.g., facilities for the handicapped, fire safety features, are satisfied.
- Lease contains provisions necessary to administer the agreement, such as duration of lease, including clearly stated renewal rights; base for future escalations; liquidated damages provision; stated costs for overtime usage; and termination rights.
- Lease conforms with agency and Administration goals and priorities and legal requirements.

APPENDIX C

SAMPLE LETTER FOR WRITTEN ASSURANCE TO THE  
AGENCY HEAD FROM DESIGNATED SENIOR OFFICIAL

Dear (agency head):

In accordance with your delegation of responsibilities to me, I have directed an evaluation of the system of internal accounting and administrative control of (name of agency) in effect during the year ended \_\_\_\_\_. As required by the Federal Managers Financial Integrity Act, this evaluation has been conducted in accordance with Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government, issued by the Director of the Office of Management and Budget, in consultation with the Comptroller General, and accordingly included an evaluation of whether the system of internal accounting and administrative control of (name of agency) was in compliance with the standards prescribed by the Comptroller General.



The objectives of the system of internal accounting and administrative control of the (name of agency) are to provide reasonable assurance that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of control procedures. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, Congressional restrictions, and other factors. Finally, projection of any evaluation of the system to future periods is subject to the risk that procedures may be inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate. Nonetheless, I have taken the necessary measures to assure that the evaluation, identified in the first paragraph, has been conducted in a thorough and conscientious manner.

The results of the evaluation, assurances given by heads of organizational units, and other information provided indicate that the system of internal accounting and administrative control of (name of agency) in effect during the year ended (date), taken as a whole, complies with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved within the limits described in the preceding paragraph. The evaluation, however, did disclose the following material weaknesses<sup>1/</sup>:

(LIST OF MATERIAL WEAKNESSES)<sup>1/</sup>

Attachment A to this report contains the recommended plans and schedules for correcting such weaknesses,<sup>1/</sup> and the status of actions taken to correct weaknesses identified in prior years' reports.<sup>2/</sup>

(SIGNATURE)

<sup>1/</sup> If there are no material weaknesses, this sentence should be deleted, and there would be no list or portion of Attachment A containing plans and schedules for correcting such weaknesses.

<sup>2/</sup> If there were no actions taken during the past year to correct weaknesses, or no identified weaknesses for which corrective actions remain to be taken, this phrase would be deleted.

APPENDIX D

SAMPLE LETTER FOR WRITTEN ASSURANCE TO THE  
AGENCY HEAD FROM THE HEAD OF AN ORGANIZATIONAL UNIT

Dear (agency head):

As (title) of the (name of organizational unit) of the (name of agency), I am cognizant of the importance of internal controls. I have taken the necessary measures to assure that the evaluation of the system of internal control of (name of organizational unit) has been conducted in a conscientious and thorough manner in accordance with Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government, issued by the Director of the Office of Management and Budget, in consultation with the Comptroller General, and accordingly included an evaluation of whether the system of internal accounting and administrative control of (name of agency) was in compliance with standards prescribed by the Comptroller General.

The objectives of the system of internal accounting and administrative control of the (name of agency) are to provide reasonable assurance that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of control procedures. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, Congressional restrictions, and other factors. Finally, projection of any evaluation of the system to future periods is subject to the risk that procedures may be inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

The results of the evaluation, performed in accordance with the guidelines identified in the first paragraph, and other information provided indicate that the system of internal accounting and administrative control of (organizational unit) in effect during the year ended (date), taken as a whole, complies with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved within the limits described in

the preceding paragraph. The evaluation, however, did disclose the following material weaknesses<sup>1/</sup>:

(LIST OF MATERIAL WEAKNESSES)<sup>1/</sup>

Attachment A to this report contains the (name of organizational unit's) plans and schedules for correcting such weaknesses,<sup>1/</sup> and the status of actions taken to correct weaknesses identified in prior years' reports.<sup>2/</sup>

<sup>1/</sup> If there are no material weaknesses, this sentence should be deleted, and there would be no list or portion of Attachment A containing plans and schedules for correcting such weaknesses.

<sup>2/</sup> If there were no actions taken during the past year to correct weaknesses, or no identified weaknesses for which corrective actions remain to be taken, this phrase would be deleted.

APPENDIX E

SAMPLE LETTER FOR COMMENTS TO THE AGENCY HEAD

FROM THE INSPECTOR GENERAL OR EQUIVALENT

Dear (agency head):

I have conducted a limited review to determine whether the evaluation of the system of internal accounting and administrative control, as described in Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government, issued by the Director of the Office of Management and Budget, in consultation with the Comptroller General, has been carried out in a reasonable and prudent manner in the (agency) for the year ended (date). During this limited review, nothing came to my attention that would indicate that the (agency) did not comply with the above-mentioned guidelines.

(SIGNATURE)

APPENDIX F

SAMPLE INTERNAL CONTROL STATEMENT

(AND REPORT, IF APPLICABLE)<sup>1/</sup>

Dear Mr. President:

An evaluation of the system of internal accounting and administrative control of (name of agency) in effect during the year ended (date) was performed in accordance with Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government, issued by the Director of the Office of Management and Budget, in consultation with the Comptroller General, as required by the Federal Managers' Financial Integrity Act of 1982, and accordingly included an evaluation of whether the system of internal accounting and administrative control (name of agency) was in compliance with the standards prescribed by the Comptroller General.

The objectives of the system of internal accounting and administrative control of the (name of agency) are to provide reasonable assurance that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of control procedures. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, Congressional restrictions, and other factors. Finally, projection of any evaluation of the system to future periods is subject to the risk that procedures may be inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

The results of the evaluation described in the first paragraph, assurances given by appropriate (name of agency) officials, and other information provided indicate that the system of internal accounting and administrative control of (name of agency) in effect during the year ended (date), taken as a whole, complies with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved within the limits described in the preceding paragraph. The evaluation, however, did disclose the following material weaknesses<sup>2/</sup>:

(LIST OF MATERIAL WEAKNESSES)<sup>1/</sup>

Attachment A to this statement contains the (name of agency) plans and schedules for correcting such weaknesses,<sup>2/</sup> and the status of actions taken to correct weaknesses identified in prior years' reports.<sup>3/</sup>

(SIGNATURE)

<sup>1/</sup> If material weaknesses in systems subject to these guidelines are found, this sample constitutes the statement and report required by the Act. If material weaknesses are not found, this sample, as adjusted, constitutes the statement required by the Act.

<sup>2/</sup> If there are no material weaknesses, this sentence should be deleted, and there would be no list or portion of Attachment A containing plans and schedules for correcting such weaknesses.

<sup>3/</sup> If there were no actions taken during the past year to correct weaknesses, or no identified weaknesses for which corrective actions remain to be taken, this phrase would be deleted.